Ontario's Tax Structure: Options for Change

A Discussion Paper

Ministry of Treasury and Economics

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Taxation Policy Branch

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Preface

Excerpt from The 1982 Budget Statement by The Honourable Frank S. Miller, Treasurer of Ontario

"Mr. Speaker, we live in a world where things are ever-changing. An important and disturbing development is that our federal government is apparently redirecting its economic priorities and indeed may have transmogrified the very way in which it views our Confederation.

"Amidst these developments, it is important for me, as Treasurer, to examine our taxation system to see if it is appropriate to this changing environment. If it is not, then we must consider making alterations, even fundamental ones.

"I must be concerned about not only what change might be appropriate, but also how major taxation change is made. Since the federal budget last November, all of us in Canada have witnessed with anguish what happens when sweeping tax moves are introduced without prior consultation. When governments try to re-write fundamentally the tax laws, they must work together with citizens and businesses in a co-operative manner. Those directly affected, not just bureaucrats and politicians, must have a real say in these matters. I would hope that the recently tabled federal discussion paper suggests a new awareness of consultation by our national government.

"Ontario believes in the consultation process. To that end, I am tabling today a discussion paper on two important areas of taxation in Ontario. I hope that this paper will stimulate discussion so that all of us in Ontario can determine what is best for our province's future. The paper deals with two issues. It discusses how Ontario could replace its existing OHIP premium structure with a health care payroll tax and shows, from a technical point of view, the impact of one way in which this could be done. In the field of personal income tax, it discusses the potential problem of continuing to be a participant in an income tax system which may not be suitable to the economic needs of Ontario.

"I would emphasize that this paper is presented for discussion and does not reflect the Government's policy at this time. In the case of health financing, I have doubts about the wisdom of abandoning our existing premium system. Nevertheless, I am asking those interested in the issues raised in the paper to submit briefs to me before the end of 1982. In the case of a possible Ontario-run personal income tax, I have asked the Ontario Economic Council, chaired by Dr. Thomas Courchene, to review the economic implications of this matter and to report to me by December.".

Ontario's Tax Structure: Options for Change
A Discussion Paper

Introduction

In 1981, the Treasurer of Ontario indicated that he would be prepared to discuss the option of replacing Ontario Health Insurance Plan (OHIP) premiums with a payroll tax.[1] The first section of this paper analyzes the economic and administrative implications of payroll taxation and outlines, in detail, the impact of one of a number of ways in which a payroll tax could be implemented. Much of the data upon which the analysis is based is derived from an extensive survey of corporations commissioned by the Ministry of Treasury and Economics. The cooperation of those involved in this survey is gratefully acknowledged.

The second part of this paper discusses Ontario's concerns about the personal income tax. Following the introduction of the November, 1981 federal budget, the Treasurer indicated that he would review the merits of the Province's continued participation in the Tax Collection Agreement. That Agreement requires the Province, which is responsible for about one-third of personal income taxes collected in Ontario, to parallel exactly federal measures. The status of the federal budget tax proposals is still unclear at this time, but certain of the measures, particularly those which erode investment incentives, are not consistent with Ontario priorities.

These sections are preceded by a brief discussion of basic objectives for Ontario's tax structure.

Objectives for the Tax System in the 1980s

Changes in tax structure must be reviewed in line with basic objectives which should guide the overall taxation system. In this context, the Ontario tax structure should be consistent with three prime objectives.

- It should generate sufficient revenue to fund the level of services which the people of Ontario require.
- It should provide an appropriate climate to encourage individuals and businesses to invest and create jobs.
- It should command broad public acceptance as to its fundamental fairness, and do so efficiently with minimal administrative burden and taxfiling complexity.

Revenue

The Government of Ontario has a solid record in fiscal management and cost control. Efforts to eliminate unnecessary spending and to improve productivity will continue through the 1980s. However, in view of the economies already achieved, scope for further major savings is somewhat limited.

[1]Hon. Frank S. Miller, "Budget Statement", *Ontario Budget 1981* (Toronto: Ministry of Treasury and Economics, 1981) p. 20.

The option of radically reducing existing levels of essential services in order to reduce pressures on the revenue base is not realistic. There may be reductions in certain areas, but there can be no dismantling of significant programs. At the same time, it is not foreseen that there will be a significant expansion of service levels. While at any given time there are numerous new programs being urged upon government, a basic responsibility of government is to determine the appropriate level of programs and services people can afford. Governments do not have any money themselves. The money for government expenditures must eventually come from the people in one form or another.

There is some question about whether the present level and structure of taxation in Ontario has the ability to produce sufficient revenue to maintain adequate levels of public services for the remainder of the 1980s. There are a number of reasons for this. First, Ontario's revenue growth tends to lag behind nominal economic growth.[2] The introduction of ad valorem taxation of fuels and tobacco in 1981 improved this situation, but these taxes account for less than 10 per cent of Ontario's own-source revenue. Second, medium-term prospects for economic growth are constrained. Third, the federal government has cut transfer payments to Ontario by almost $400 million per year, on average, for the next five years.[3]

Incentives

The present tax system provides a number of investment and job-creation incentives. Yet, there may also be good reason to provide new or expanded tax preferences to meet the economic challenges ahead. In particular, in times of uncertainty, individuals and corporations alike tend to be less confident. This means less innovation, risk taking and investment, which are exactly the things Ontario's economy needs most if it is to adapt to new technologies and changing world markets. It is crucial that the tax system be as supportive as possible of these activities.

Fairness and Efficiency

The fairness of a tax system is more a matter of subjective judgement than something that can be measured objectively. For example, some people believe the personal income tax is the best of all taxes because of its progressivity. Others criticize the tax for eroding individual initiative and risk taking. As long as people have different perceptions about the non-revenue purposes of taxation, there will be legitimate but irreconcilable differences of opinion on the equity of any tax system.

There are, however, some clear guides to the perceived fairness of a tax system. These are its public acceptability and ease of administration. A tax system which is well accepted by an informed public implies a broad consensus that the distribution of tax burdens is reasonable. Similarly, if a tax system is generally regarded as fair, it will be relatively simple to administer because there will be a high degree of voluntary taxpayer compliance.

[2]Hon. Frank S. Miller, "Fiscal Developments in Ontario in the 1970s", Budget Paper A, *Ontario Budget 1981* (Toronto: Ministry of Treasury and Economics, 1981).

[3]Hon. Frank S. Miller, "Fiscal Federalism in Canada: The Record to Date The Challenge Ahead", Budget Paper B, *Ontario Budget 1982* (Toronto: Ministry of Treasury and Economics, 1982).

I Health-Care Financing

Current System

OHIP premiums were originally introduced to raise funds for Ontario's health-care programs in a direct manner and to establish a clear relationship between costs and service. Premiums currently contribute about 20 per cent of the financing of health care in Ontario.

The current premium structure is two-tiered, with annual rates of $324 and $648 for single persons and families, respectively. These rates are waived for social assistance recipients, people 65 years and over, and those who are experiencing temporary financial difficulty. They are also eliminated or reduced for low-income individuals and families. Any organization with 15 or more employees must establish a group plan and remit premiums on the group's behalf. Individuals not covered by group plans must remit their premiums directly. In 1981-82, groups accounted for 85 per cent of revenues, the remainder coming from pay-directs. Almost 82 per cent of group payments were paid by employers as fringe benefits.

OHIP Premiums and Premium Assistance, 1982 — Table I-1
(dollars)

	Single	Family
Annual Premiums	324[1]	648[1]
Premium Assistance	Taxable Income Limits	
100%	3,000	3,500
75%	3,500	4,500
50%	4,000	5,000
25%	4,500	5,500

[1]Effective for the benefit month October 1982.

The premiums paid by corporations on behalf of their employees are treated as an expense of doing business and therefore are deductible for corporation income tax purposes. On the other hand, they are treated as taxable benefits for employees. Premiums paid directly by individuals are not tax deductible as medical expenses.

Escalating health-care costs and the low natural growth of premium revenue have meant that periodic rate increases have not prevented the portion of health spending covered by premiums from declining, as shown in Table I-2.

Examining Alternatives

Premiums continue to be an effective financing tool. They are neutral with respect to the consumption of health services and consistent with the Province's economic and fiscal objectives, and they provide a visible link to health costs.

Nevertheless, debate and controversy over premiums continue. In 1978, some members of a Select Committee of the Legislature, in reviewing Ontario's health-care financing, took issue with premiums as an appropriate financing method and criticized them as unfair and regressive.[4]

[4]*Report of the Select Committee on Health Care Financing and Costs* (Toronto: Legislature of Ontario, 1978).

OHIP Premiums and Health Costs — Table I-2

	Monthly Premium Rate	Premium Revenue	Ontario Health Costs	Premium Revenue as a % of Health Costs
	($ single/family)	($ million)	($ million)	(%)
1972-73	11/22	520	1,962	26.5
1973-74	11/22	530	2,128	24.9
1974-75	11/22	548	2,612	21.0
1975-76	11/22	573	3,111	18.4
1976-77	16/32	799	3,582	22.3
1977-78	16/32	840	3,864	21.7
1978-79	19/38	977	4,185	23.3
1979-80	20/40	1,037	4,558	22.8
1980-81	20/40	1,061	5,255	20.2
1981-82[1]	23/46	1,179	6,185	19.1
1982-83[2]	27/54	1,402	7,030	19.9

Source: Ontario Treasury.
[1]Interim.
[2]Estimate.

A 1980 federally-commissioned study on the state of health services in Canada suggested that premiums be abolished as economic conditions improve.[5] That position is premised on the view that premiums act as a barrier to universal health-care access. However, health services are never withheld from those who may have had difficulty meeting premium payment responsibilities, even though there may be perceptions to the contrary.

On the other hand, the Taylor Committee supported the retention of premiums.[6] This Committee recommended that direct individual financial participation be maintained to improve user awareness of health-care costs. It went even further and recommended indexing health premiums to represent approximately one-third of total insured health costs in Ontario. In 1979, the Province published a paper reviewing various existing financing alternatives such as the personal and corporate income taxes and the retail sales tax.[7] It concluded that it would be inappropriate to shift the health financing burden to any of these taxes.

In the 1981 Budget, the Treasurer of Ontario expressed his intention to review alternatives to premiums to determine the suitability of other revenue sources, such as a payroll tax. The need for a review has been intensified by the unilateral federal cutbacks in funds transferred to Ontario under the Established Programs Financing arrangements.[8]

Structuring a Payroll Tax

A payroll tax is a levy on wages and salaries and on the income of the self-employed.[9] Such taxes are not unfamiliar to Canadians. The Unemployment Insurance program, administered by the federal government since 1940, is financed for the most part by a

[5]Hon. Emmett M. Hall, CC., Q.C., *Canada's National-Provincial Health Program for the 1980s, A Commitment for Renewal* (August 1980).

[6]*Report of the Joint Advisory Committee of the Government of Ontario and the Ontario Medical Association on Methods to Control Health Care Costs* (Toronto, 1977).

[7]Hon. Frank S. Miller, "Financing OHIP in Ontario: A Discussion Paper", Budget Paper D, *Ontario Budget 1979* (Toronto: Ministry of Treasury and Economics, 1979).

[8]Hon. Frank S. Miller, "Fiscal Federalism in Canada: The Record to Date The Challenge Ahead", *op. cit.*

[9]Investment income bears characteristics that are different from wages and salaries, and is not normally included in a payroll tax base.

payroll tax on wages and salaries up to an indexed ceiling.[10] Financing is shared by the employer and employee.

The Canada Pension Plan, introduced in 1966, is also funded by a payroll tax. This tax differs from the unemployment insurance levy in that there is a base amount of wages that is exempt.[11]

Quebec levies a payroll tax to fund part of the cost of its health services program. Formerly shared by employers and employees, this tax was changed in 1978 to a levy on employers only. At present, the tax is three per cent of the wage bill without a floor or ceiling. Other countries, such as the United States and the United Kingdom, also use payroll taxes to finance social programs.[12]

A Payroll Tax Base

Payroll taxes usually take one of two basic forms. They may be levied entirely on employers and the self-employed, or shared with employees. Whether a payroll tax is shared or employer-paid, ceilings or floors can be introduced to narrow the impact of the tax.

With the current cost of premiums shared 70 per cent by employers and 30 per cent by individuals, it is not clear whether a shared or an employer-paid tax would be superior on the basis of its ultimate burden and incidence on individuals. What is clear, however, is that a shared tax would bear less heavily on business in general and on small business in particular.

The criterion of administrative complexity is also important in assessing payroll tax structures. And, while the comparative impacts on burden and incidence may be indeterminate, administrative complexity is clearly lowest for employer-paid taxes without floors or ceilings. The existence of well established procedures for income tax withholdings, for the Canada Pension Plan and for Unemployment Insurance simplifies potential administrative problems for the employer and the self-employed, and reinforces the preferability of collecting the tax at that level. Were the employer to be required to withhold any portion of the tax from the employee, a complex individual reporting system would have to be created. The administrative load would be far less significant for some 280,000 employers and 200,000 self-employed persons than if tax were collected from over four million employees.

In analyzing the implications of a switch to payroll taxes, any or all of the various structures could be examined. For illustrative purposes, and to spur discussion, an employer-paid tax with no floor or ceiling will be assessed in this paper. It is not suggested that this is necessarily the preferred alternative.

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[10]The 1982 employer/employee split is 2.31 per cent/1.65 per cent of salaries up to $18,200. The combined employer/employee tax in 1982 is a maximum of $720.72.

[11]The employer and employee rates are equal at 1.8 per cent, and the indexed base and ceilings in 1982 are $1,600 and $16,500, respectively. Thus, the maximum employer/employee contribution in 1982 is $536.40.

[12]In the U.S., a payroll tax finances social security payments. This tax, introduced in 1935 by the federal government, finances old age, survivors' and disability benefits, as well as hospital and medical benefits for persons 65 years and over.

The United Kingdom uses a payroll tax to finance partly a plethora of social benefits, including health services, unemployment, retirement, disability, sickness and maternity benefits. The tax, known as the contribution to national insurance, is levied on both employers and employees up to a certain unindexed ceiling, with employers paying a higher rate than employees.

A Two Per Cent Rate of Tax

Premiums bear directly on other revenue sources of the Province. Deductibility of premiums paid by employers reduces their corporation income tax liability. Premiums paid by employers are taxable benefits to the employees, and hence boost personal income tax revenue. A payroll tax paid by employers would be deductible for corporate income tax purposes but would not impact on employees' personal income tax liabilities. In considering replacing premiums with a payroll tax, the desired net revenue yield from a simple payroll tax would have to equal the current net revenue yield of premiums in the first year.

Table I-3 illustrates the net revenue yield of premiums in 1982-83 and the payroll tax level necessary to replace them. Gross premium revenue of $1,400 million is supplemented by an additional $98 million in personal income tax revenues, and offset by reduced corporate income tax revenues of $48 million. The net revenue yield of premiums is $1,450 million. This amount then must be generated by the payroll tax. Since it, too, would be deductible, the gross yield of the payroll tax would have to be $1,525 million to account for a $75 million corporate tax loss. This would require a rate of 2 per cent on the basis of current wage and salary estimates for Ontario.

Ontario Premium and Payroll Tax Revenue Compared, 1982-83 — Table I-3
($ million)

	Premium System	Payroll Tax System
Gross Revenue	1,400	1,525
PIT Impact	98	—
CIT Impact	(48)	(75)
Net Revenue	1,450	1,450

Source: Ontario Treasury.

The Effects of a Move to a Payroll Tax

Replacement of OHIP premiums with an employer-paid tax of 2 per cent of the total value of wages and salaries would carry with it a redistribution of almost $1.5 billion in taxes. This would imply unavoidable disturbances in the existing burdens on individuals and corporations, in tax administration and in government revenue flows. The extent and effect of these disturbances depend on a number of factors and differ substantially in the short and long run. Choosing an appropriate burden-shifting analysis from the myriad of possibilities depends on one's view of how the initial effects are absorbed and how individuals and employers adapt to the change. There are two polar cases.

First, the burden may be borne entirely by employers and the self-employed, primarily in the private sector. Indeed, these results could be expected in the extreme short term if the change could be implemented rapidly.Table I-4 shows the immediate impact. Employees would experience initial benefits in direct proportion to the premiums they currently pay. Simultaneously, increases would occur in direct total costs for employers and some of the self-employed. Premiums currently paid by pay-directs, as well as the portion now borne by employees in group plans, would be shifted to employers and the self-employed. Also, the dollar value of payroll taxes must be somewhat greater than that of premiums if equivalent revenue were to be raised net of income tax implications. Finally, among the self-employed, those previously covered by someone else's plan and those with high incomes would experience cost increases. Changes in cash outflow amongst employers would occur because rarely would current direct OHIP costs exactly equal direct payroll tax costs.

Second, if employers can shift the burden of the tax over time, employees and/or consumers may bear the long-run incidence of payroll taxes or premiums, no matter who bears the initial costs. Such shifting may occur through a lower rate of wage increases over time (backward shifting) or through product price increases (forward shifting). The direction of the shift will depend on many factors.[13] The other extreme case then would occur if employees bear fully the ultimate consequences of the change.

Initial Shift in Total Costs of Gross Health Related Revenues, 1982-83 — Table I-4
($ million)

	Premiums	Payroll Tax
Employers		
Corporations	725	1,085
Other[1]	255	360
	980	1,445
Individuals	420[2]	80[3]
Total	1,400	1,525

Source: Ontario Treasury.

[1]Includes the public sector plus charitable and religious organizations.

[2]Pay-directs plus employee portion of group payments.

[3]Self-employed.

A. Immediate Impact on Business

Several factors determine both the magnitude and direction of the immediate cash outflow impact on business of a shift to a payroll tax. The most significant of these factors are: (a) the percentage of OHIP premiums currently paid by employers, (b) the percentage of employees not covered under their employer's group plan, (c) the ratio of married to single accounts and (d) the average employee wage. For example, an employer now paying a very small portion of premiums would experience an increase in cash outflow if a payroll tax were implemented. Further, even though an employer may offer to pay OHIP premiums, some employees, for various reasons, may not be included in the plan. An employer with a relatively high exemption ratio would be more likely to experience an increase in cash outflow than one with a lower ratio, other things being equal.

The average employee wage would also affect the cash outflows. For example, a low average wage in combination with even typical current premium coverage implies relatively low cash outflow consequences if a payroll tax were introduced. Also, an employer with a high ratio of married/single accounts would experience a better cash outflow shift than one with a lower ratio, other things being equal.

To identify those industries which would be most affected by a shift to payroll taxes, 23 industries were surveyed to determine the extent to which the factors discussed above would have resulted in high or low net costs if the switch to a payroll tax had been made in 1981.[14]

[13]The degree of openness of the Ontario economy will, in many ways, determine the extent of the ultimate adjustments. Wage and price changes in Ontario as a result of payroll/premium burden-shifting will be influenced by international and national wage and price trends in labour and product markets.

[14]A sample survey of firms in 23 industry sectors was undertaken by the management consulting firm, Woods Gordon, on behalf of the Ontario Treasury. The firms, grouped by size in each industry, were asked for information on specific employee characteristics that impact most directly on premiums and payroll taxes.
The industries are classified by activity in the same manner as the Standard Industrial Classification (1960 basis). Forestry, mining, construction, finance and related, and transportation and related are all analyzed at the highest level of aggregation. Because of the sheer size of the manufacturing sector in the economy of Ontario, that industry was disaggregated into 14 subsectors; trade is disaggregated into wholesale and retail; and services into recreational and business, and personal.

Table I-5 provides basic data, both by industry sector and size of firm, on the level of OHIP premium coverage in Ontario. Column A shows the percentage of total premiums paid by employers. This varies from 100 per cent in the machinery (except electrical) sector to 43.8 per cent in the construction industry.

OHIP Premium Coverage and Average Wages in the Ontario Private Sector, 1981 — Table I-5

Industry	(A) Premium Portion Paid by Employer	(B) Portion of Employees Not Covered Under Employer's Plan	(C) Ratio of Married to Single Accounts	(D) Average Wage
	(%)	(%)		($)
1. Forestry	68.9	38.6	2.44	24,470
2. Mining	99.1	12.6	4.92	23,683
3. Food, Beverages and Tobacco Products	90.2	19.7	3.20	18,956
4. Rubber Products	95.7	13.8	3.05	17,450
5. Leather and Textiles, Knitting Mills and Clothing	77.4	35.9	1.83	13,401
6. Wood Products	85.1	21.8	2.58	15,049
7. Furniture and Fixtures	78.7	21.0	2.73	16,514
8. Paper and Allied	91.7	11.6	2.86	22,858
9. Printing, Publishing and Allied	63.7	24.2	1.99	22,104
10. Primary Metal	94.0	7.9	3.68	22,435
11. Metal Fabricating	97.5	17.2	3.00	19,063
12. Machinery except Electrical	100.0	10.9	3.33	23,018
13. Transportation Equipment	98.8	8.1	5.40	23,791
14. Electrical Products	85.6	19.2	2.42	21,849
15. Non-Metallic Mineral Products	98.0	11.5	3.12	19,885
16. Petroleum, Coal and Chemical Products	88.2	15.0	2.81	22,833
17. Construction	43.8	71.5	2.43	20,324
18. Transportation, Communications and other Utilities	69.6	23.8	2.06	19,356
19. Wholesale Trade	81.8	18.0	2.10	21,452
20. Retail Trade	78.3	53.5	1.61	11,362
21. Finance, Insurance and Real Estate	60.1	39.0	1.06	15,432
22. Recreational and Business Services	57.5	56.1	1.58	18,331
23. Personal Services	54.9	57.5	1.23	12,325
By Size[1]				
Small	71.4	34.1	1.81	15,990
Medium	84.5	23.3	2.40	18,241
Large	87.0	23.6	2.95	19,120
Overall Average	78.7	37.6	2.09	17,533

Source: Ontario Treasury-sponsored private survey.

[1]Small is defined as under 50 employees; medium is 50 to 499 employees; and large is 500 or more employees.

Column B shows the percentage of employees in each sector who do not participate in employer-paid plans. This may occur because there is no plan, they receive coverage under another's plan, they are temporary employees, or, in a few cases, they are over

Table I-6

Shifts in Industry Net Cash Outflow Created by a Payroll Tax, 1981

($ million)

Industry	OHIP Payment (1)	Payroll Tax (2)	Difference (2)-(1)	Effect on Corporate Income Tax	Net Cash Outflow	Net Cash Outflow as a % of Payroll
1. Forestry	1.6	3.7	2.1	−1.0	1.1	0.61
2. Mining	16.7	18.3	1.6	−0.7	0.9	0.09
3. Food, Beverages and Tobacco Products	36.9	39.4	2.5	−0.9	1.6	0.08
4. Rubber Products	14.7	13.1	−1.6	0.6	−1.0	−0.16
5. Leather and Textile Products, Knitting Mills and Clothing	18.7	22.0	3.3	−1.2	2.1	0.18
6. Wood Products	6.7	6.3	−0.4	0.2	−0.2	−0.10
7. Furniture and Fixtures	7.3	8.0	0.7	−0.3	0.4	0.11
8. Paper and Allied	22.3	26.3	4.0	−1.5	2.5	0.19
9. Printing, Publishing and Allied	12.7	25.5	12.8	−4.8	8.0	0.63
10. Primary Metal	36.7	37.5	0.8	−0.3	0.5	0.03
11. Metal Fabricating	32.7	31.8	−0.9	0.3	−0.6	−0.03
12. Machinery, except Electrical	25.2	26.2	1.0	−0.4	0.6	0.05
13. Transportation Equipment	53.8	55.2	1.4	−0.5	0.9	0.03
14. Electrical Products	31.3	40.6	9.3	−3.5	5.8	0.29
15. Non-Metallic Mineral Products	11.8	11.8	0	0	0	0
16. Petroleum, Coal and Chemical Products	16.8	25.9	9.1	−3.4	5.7	0.44
17. Construction	9.9	74.2	64.3	−29.6	34.7	0.94
18. Transportation, Communication and other Utilities	55.2	94.3	38.8	−17.8	21.0	0.45
19. Wholesale Trade	65.8	85.8	20.0	−9.2	10.8	0.22
20. Retail Trade	72.2	101.0	28.8	−13.3	15.5	0.31
21. Finance, Insurance and Real Estate	32.4	70.6	38.2	−17.6	20.6	0.58
22. Recreational and Business Services	40.4	131.7	91.3	−42.0	49.3	0.75
23. Personal Services	32.9	82.2	49.3	−22.7	26.6	0.65

Source: Ontario Treasury-sponsored private survey.

age 65.[15] Column C shows the ratio of married to single accounts and column D indicates the average wages in 1981 for each of these sectors.

Table I-6 compares the initial effects for the 23 industries and sub-industries if premiums had been converted to a 2 per cent payroll tax in 1981. There would have been considerable swings, from a cost decrease of $1.6 million in the rubber products industry to a cost increase of $91.3 million in the recreational and business services sector. However, it is more accurate to measure the shift on an after-tax basis.[16] Industries which experienced an increase in payments would have had their corporation income taxes reduced and, conversely, those with a reduction in payments would have experienced an increase. The after-tax cash outflow shifts range from a reduction of $1 million in the rubber products industry to an increase of $49.3 million in the recreational and business services industry.

To measure relative changes, the cash outflow shifts are expressed as a percentage of wages and salaries in the final column.[17] No industry group would experience a shift in excess of 1 per cent of payroll and only six exceed 0.5 per cent. The rest show little net impact and, of the 23 industries analyzed, 12 experience effective cash outflow changes that are less than 0.2 per cent of their payroll. Eight of these would be 0.1 per cent or less.

The construction industry appears to be affected most seriously. However, this can be explained in terms of the special nature of this industry. Because employees tend to have a shorter term attachment to any one employer in this industry, they do not, in many cases, receive employer-paid OHIP coverage. However, the level of employer-paid premiums is a misleading indicator in this case since employers often make contributions to a union-administered benefits plan, from which OHIP premiums and other benefits may be paid. Those contributions are usually based on the number of hours worked by union members. Strictly speaking, therefore, while many employers do not pay OHIP premiums directly, they do experience other costs in respect of OHIP coverage which would be eliminated under a payroll tax.

Effects on Cash Outflow by Type of Firm

Table I-7 aggregates the data by size and type of firm. It shows the impact on small, medium and large firms on an overall basis and in the high technology and export sectors.[18]

On an industry-wide basis, each size group would have experienced an increase in payments with the introduction of a payroll tax. Due to the low level of employer-paid premiums, small business would have experienced the highest immediate increase in costs. This disproportionate impact on small business would be a major consideration in assessing the viability of payroll taxation.

In the high technology sector, there would have been an increase in cash outflow in each of the large, medium and small groups, with the largest absolute increase recorded

[15]It is tax advantageous for a person to opt for coverage under the plan of the lower income spouse, if the plans are identical.

[16]The assumption made here is that all companies are profitable; to the extent that this is not the case, the offsetting corporate tax changes are lost. Further, not all of the industries are affected by corporate taxes to the same degree. Those which currently receive preferential corporate income tax treatment, such as manufacturing and mining and small business would naturally be affected to a lesser degree than others. The results in no way reflect the consequences for individual companies. Within each group, there will be individual firms in better or worse relative positions.

[17]The best measure of relative cost would be cash flow against total operating costs, but due to lack of data, the measure relates to labour costs only.

[18]High technology includes, primarily, electronics instrumentation and computer technology industries, while export covers primarily aerospace, communications, transportation, machinery, appliance, and resource industries.

Shifts in Gross Industry Cash Outflow by Size, 1981 — Table I-7

	Average Premium[1]	Average Payroll Tax[1]	Difference[2]	Difference as a % of Wages and Salaries
	($)	($)	($)	(%)
Industry-Wide				
Large	310	382	72	0.38
Medium	307	364	57	0.32
Small	213	320	107	0.67
High Technology				
Large	312	364	52	0.29
Medium	103	239	136	1.13
Small	302	467	165	0.71
Export				
Large	451	432	−19	−0.09
Medium	442	428	−14	−0.06
Small	270	446	176	0.79

Source: Ontario Treasury-sponsored private survey.

[1]Average premium or payroll tax is equal to premiums or payroll tax paid by the employer divided by number of employees.

[2]These differences would be diminished in magnitude by corporate tax effects.

for the small firm. When expressed as a percentage of wages, however, the most significant shift would have been for medium size firms. In the export sector, large and medium firms would have experienced savings, while small firms would have experienced an increase in costs.

B. Long-Term Incidence

For purposes of this analysis, the other extreme assumption is that the individual would bear the ultimate effects of the change. Under this scenario, the impact on individuals varies since the ultimate incidence of both premiums and payroll taxes may be felt in wage levels and/or prices. For the following brief analysis, the extreme assumption is made that the entire impact is ultimately borne by individuals through a reduction in wages.

To assess these shifts properly, the burden must be measured after wage and personal income tax effects. For instance, if an employer pays premiums, wages would be reduced by an amount equal to premiums in the long run. By the same assumption, the implementation of a payroll tax would result in a reduction in the employee's wage by an amount equal to the tax in respect of that employee. This reduction would in turn lower the income tax that would have been paid by the employee.

The result under these assumptions is illustrated in Table I-8. It shows that a shift in burden would occur from middle-income to high-income individuals and families. A shift would also occur in the case of certain low-income persons. This is explained by the fact that this group would no longer receive the benefit of the premium subsidies available today.

C. Public Sector

Public sector employers would of course also be liable for the payroll tax. Unlike the private sector, however, the immediate added costs would not be reduced by corporate

Imputed Impact on Individuals of a Switch to Payroll Tax, Assuming 100 Per Cent "Backward Shifting", 1982

Table I-8

(dollars)

	Single					Married[2]				
Gross Earnings	Imputed Premium[1]	Imputed Gross Payroll Tax	PIT Reduction	Imputed Net Payroll Tax	Difference (4)-(1)	Imputed Premium[1]	Imputed Gross Payroll Tax	PIT Reduction	Imputed Net Payroll Tax	Difference (4)-(1)
	(1)	(2)	(3)	(4)	(5)	(1)	(2)	(3)	(4)	(5)
2,000	—	40	—	40	40	—	40	—	40	40
4,000	—	80	—	80	80	—	80	—	80	80
6,000	—	120	28	92	92	—	120	—	120	120
8,000	162	160	40	120	−42	—	160	—	160	160
10,000	324	200	53	147	−177	—	200	47	153	153
15,000	324	300	84	216	−108	648	300	80	220	−428
20,000	324	400	118	282	−42	648	400	112	288	−360
25,000	324	500	185	315	−9	648	500	170	330	−318
30,000	324	600	222	378	54	648	600	222	378	−270
40,000	324	800	355	445	121	648	800	296	504	−144
60,000	324	1,200	604	596	272	648	1,200	533	667	19
80,000	324	1,600	805	795	471	648	1,600	805	795	147
100,000	324	2,000	1,006	994	670	648	2,000	1,006	994	346

Source: Ontario Treasury.

[1]Direct cost to pay-direct and implicit wage cost to those with employer-paid premiums.

[2]Married means one-income earner family. Impact on two-income earner families is calculated as the imputed burden of premiums less the combined imputed net payroll tax burden of two singles.

income tax savings. Table I-9 presents the 1981 results for those factors which determine the extent of changes in cash outflows for selected categories in the public sector, and Table I-10 indicates the magnitudes of those changes.

The cost increases are estimated to vary from a high of $33.6 million for the federal civil service to a low of $1.4 million for the municipal sector. When expressed as a percentage of wages and salaries, the swings experienced by the federal civil service in Ontario would also have been the greatest, reflecting mainly the present low level of employer-paid premiums.

OHIP Premium Coverage and Average Wages in the Public Sector in Ontario, 1981 — Table I-9

	Premium Portion Paid by Employer	Portion of Employees Not Covered Under Employer's Plan	Ratio of Married to Single Accounts	Average Wage
	(%)	(%)		($)
Ontario Public Service	100.0	18.5	3.07	21,956
Ontario Hydro	100.0	28.1	4.50	28,570[1]
Elementary and Secondary School Teachers	82.2	25.2	2.66	28,600
Colleges[2]	100.0	23.6	2.98	23,913
Municipal Sector	98.0	20.0	3.00	19,913
Federal Civil Service in Ontario	44.1	29.2	1.66	24,370

Source: Ontario Treasury survey.
[1]Estimate.
[2]Full-time employees only.

Cash Outflow Shifts in the Public Sector in Ontario, 1981 — Table I-10

	OHIP Payment	Payroll Tax	Difference	As a Per Cent of Payroll
	($ million)	($ million)	($ million)	(%)
Ontario Public Service	29.7	33.0	3.3	0.20
Ontario Hydro	11.7	18.0[1]	6.3	0.70
Elementary and Secondary School Teachers	34.3	55.0	20.7	0.75
Colleges[2]	5.1	6.6	1.5	0.46
Municipal Sector	41.9	43.3	1.4	0.06
Federal Civil Service in Ontario	13.4	47.0	33.6	1.43

Source: Ontario Treasury survey.
[1]Estimate.
[2]Full-time employees only.

D. Effects on Government Finances

A change from premiums to payroll taxes would affect both government revenues and expenditures, aside from the direct impact on employer-related costs.

- Personal income tax revenues for both federal and Provincial governments would be reduced.
- Corporate taxes at both levels would be altered.

- Federal spending on equalization payments would be increased, with corresponding revenue increases for equalization-recipient provinces.

Elimination of premiums would affect the revenues of the federal government directly in two ways. First, because the employer-paid portion of OHIP premiums is a taxable benefit, personal income tax revenues would decline. Second, because these same employer-paid premiums are a deductible expense of doing business, corporate tax revenues would increase with their elimination. Simultaneously, a payroll tax is presumed to be deductible for corporate tax purposes (as it is in Quebec) and hence would reduce corporate income tax revenues. The net effect of replacing premiums with a payroll tax would be to reduce federal revenues by about $300 million per year. Federal transfers to recipient provinces under the equalization formula would also increase by $43 million.

As was illustrated in Table I-3, the changes also affect Ontario's share of personal income taxes and its corporate income tax revenues. Table I-11 summarizes the immediate revenue and equalization impacts for the federal and Ontario governments.

Impact on Government Finances[1], 1982-83 — Table I-11

($ million)

	Elimination of Premiums	Payroll Tax	Net
Federal Government			
Personal Income Tax	(205)	—	(205)
Corporate Income Tax	213	(315)	(102)
Equalization Payments	32	(75)	(43)
Total	40	(390)	(350)
Ontario Government			
Premium/Payroll Tax	(1,400)	1,525	125
Personal Income Tax	(98)	—	(98)
Corporate Income Tax	48	(75)	(27)
Total	(1,450)	1,450	(0)

Source: Ontario Treasury.

[1]Excludes direct cost of the payroll tax to governments as employers.

The most fundamental long-term consequence for Provincial revenues arises from the stronger revenue growth potential of a payroll tax relative to OHIP premiums, since

Growth of Wage Base, Premiums and Health Costs — Table I-12

(per cent)

Fiscal year	Wages and Salaries[1]	OHIP Premium Revenue	Ontario Health Costs
1973	14.8	1.9	8.5
1974	17.2	3.4	22.7
1975	14.3	4.6	19.1
1976	14.5	39.4	15.1
1977	10.0	5.1	7.9
1978	8.5	16.3	8.3
1979	10.7	6.1	8.9
1980	9.6	2.3	15.3
1981	13.4	11.1	17.7
1981/1972	189.3	126.7	215.2

Source: Ontario Treasury.

[1]Growth on a calendar year basis.

its growth rate would parallel the growth of the wage base. If an uncapped payroll tax had been introduced in Ontario in place of premiums in 1972, its revenue would have increased by almost 190 per cent by 1982. Premium revenue has increased by only 127 per cent during the same period, despite rate increases. Table I-12 compares the growth of Ontario's wage and salary base with the growth of premium revenues and health costs.

Administration of a Payroll Tax

Relatively simple payroll tax structures pose no greater complexity than existing administrative requirements for personal income taxes, the Canada Pension Plan, Unemployment Insurance, or OHIP premiums.

The survey referred to earlier asked for opinions on the administrative convenience of payroll taxes versus OHIP premiums. Overall, the response was favourable to payroll taxation, but there was some variation depending on the size of the firm. Almost 90 per cent of large firms consider payroll taxes to be either as or more convenient than premiums. This figure is approximately 74 per cent for medium-size firms but only 43 per cent for small firms. These results can be explained by the fact that large firms tend to have greater flexibility to make calculations in respect of payroll taxes by virtue of automated payroll systems. This capacity would be somewhat less for medium-size firms and lacking in most small firms, although it is only an important consideration if the payroll tax has either a floor or a ceiling. This pattern of attitudes remains fairly constant among the 23 industries analyzed and, on balance, firms appear to prefer the administrative convenience of a payroll tax compared to premiums.

In addressing administrative feasibility, there are several basic options. A simple tax incorporating a flat percentage of payroll costs levied on employers and the self-employed, could be administered in three ways.

- **Federal Administration**

  Employers would remit monthly payments to Revenue Canada, which in turn would forward tax collected to Ontario.

  Consistent with the current personal income tax system, self-employed individuals would remit tax quarterly and file an annual income tax return including payroll tax provisions. Revenue Canada in turn would forward the tax collected to Ontario.

- **Shared Administration**

  Employers would remit monthly payments directly to Ontario and Revenue Canada would audit employers' compliance as a by-product of its established payroll audit activity.

  Self-employed individuals would remit quarterly payments directly to Ontario and Revenue Canada would audit compliance as a by-product of their income tax system.

- **Provincial Administration**

  Ontario would perform all functions necessary to administer the tax, including audit.

The most efficient alternative would be federal administration, provided a realistic administrative charge could be negotiated and problems of intergovernmental bureaucratic entanglement minimized. It should be also noted that, with the current OHIP system, Ontario already has a revenue collection system which provides the potential for certain efficiencies if Ontario were to administer a payroll tax.

More complex taxes would certainly be feasible but would diminish the likelihood of federal cooperation and increase potential costs.

Timing

The timing for implementation of a payroll tax depends on the nature of the administrative machinery and the structure of the tax itself. In rough terms, a two year phase-in period would likely be necessary. Thus, the earliest possible implementation date would be 1985.

II Reassessing Ontario's Role in Personal Income Taxation

The Personal Income Tax in Ontario

Both the federal and provincial governments levy personal income taxes.[19] Under the Tax Collection Agreements, participating provinces accept the federal structure of income taxation and, in exchange, the federal government collects the taxes for both levels at no administrative cost to the provinces. Ontario and all other provinces except Quebec have Tax Collection Agreements with Ottawa. The result is that taxpayers in these nine provinces see only one deduction for income tax on their pay stubs and fill in only one tax return.[20]

The federal government defines virtually all aspects of the income tax structure, including:

- the types of income subject to tax;
- exemptions and deductions from income; and,
- marginal rates, brackets and indexation factors.

The current Agreements allow provinces to make independent decisions in two areas. First, provinces can determine the total amount of income tax they wish to raise by setting the percentage of basic federal tax levied for their own purposes. Ontario's rate is 48 per cent of basic federal tax. Second, provinces can, subject to federal approval, allow various tax credits. At present, Ontario provides property and sales tax credits, a temporary home heating credit and a political contribution credit.

As Table II-1 shows, the personal income tax is the most important source of tax revenue in Ontario and, in the last two years, accounted for over 40 per cent of the Province's total own-source tax revenue.

Contribution of Personal Income Tax to Ontario Tax Revenues — Table II-1

	Personal Income Tax Revenue[1]	Total Tax Revenue[1]	PIT as a % of Total Revenue
	($ million)	($ million)	(%)
1977-78	2,447	6,653	36.8
1978-79	2,735	6,947	39.4
1979-80	3,183	8,558	37.2
1980-81	3,578	9,449	37.9
1981-82[2]	4,928	11,132	44.3
1982-83[2]	5,584	12,576	44.4

Source: Ontario Treasury.

[1]Tax revenue is net of Ontario Tax Credits.

[2]Interim figures for 1981-82 and estimates for 1982-83 reflect increases in the Ontario personal income tax rate. In addition, the replacement of Ontario Tax Credits with direct tax grants for senior citizens has the effect of increasing the relative importance of personal income tax revenue.

[19]For an historical review of the personal income tax arrangements, see Appendix A to this Paper.

[20]Appendix B reproduces the personal income tax form.

Table II-2 demonstrates the redistributive feature of the income tax system. For example, in 1979, taxpayers with incomes below $20,000 represented 71.4 per cent of all taxpayers but paid 39.5 per cent of total Ontario income tax. As income increases, the relative burden of tax rises.

Distribution of Taxpayers by Income Class, and Ontario Income Tax Paid, 1979 — Table II-2

Gross Income	Taxpayers	Cumulative Distribution	Ontario Income Tax	Cumulative Distribution
($)	(%)	(%)	(%)	(%)
less than 5,000	0.8	0.8	0.1	0.1
5,000-10,000	22.9	23.7	5.8	5.9
10,000-15,000	26.6	50.3	14.4	20.3
15,000-20,000	21.1	71.4	19.2	39.5
20,000-25,000	13.3	84.7	17.4	56.9
25,000-35,000	10.1	94.8	19.2	76.1
35,000-50,000	3.3	98.1	9.8	85.9
50,000-75,000	1.2	99.3	5.5	91.4
75,000-100,000	0.3	99.6	2.7	94.1
100,000 and above	0.3		6.0	
	100.0	100.0	100.0	100.0

Source: Ontario Treasury.
Note: Totals may not add due to rounding.

The personal income tax is by far the largest tax paid by many individuals. Even slight changes in the structure of this tax can have a strong effect on economic behaviour. Not only is this tax a cardinal revenue-raising device for governments, but it is also a major instrument for providing economic incentives.

These incentives are designed to encourage a specific type of saving, investment or expenditure by individuals. For example, the encouragement of savings has been prevalent in recent years. The deduction for Registered Home Ownership Savings Plans and the significant expansion of limits for pension plan contributions are prime examples. In addition, some tax preferences, such as the $1,000 investment income deduction and the dividend tax credit, were put in place to encourage investment in Canada. For many years, the federal government encouraged individuals to participate in the development of new businesses and the expansion of existing ones. Taxpayers could deduct from income all interest paid on borrowed funds used for investment purposes even though returns from the investment might be some years away. In addition, special capital cost allowance provisions have been used to encourage the production of Canadian films, the construction of rental buildings and the exploration for oil and gas.

An equally important incentive is the absolute level of tax rates and the marginal rate structure. If an individual perceives tax rates to be too high, he might be dissuaded from investing his time and/or financial resources in work, business or investment. The level at which tax rates are perceived to be too high will not necessarily be the same for all individuals.

Since the conclusion of the income tax reform exercise of the early 1970s, Ontario and the federal government have had a basically harmonious relationship in the field of income taxation. Ottawa integrated Ontario's property and sales tax credit program into federal administration. Ontario has been supportive of most of the federal government's policies for personal income tax levels, incentives and tax administration. In fact, in the

decade preceding the 1981 federal budget, the personal income tax system stood as an example of how the two levels of government could cooperate effectively in the administration of a highly complex tax field which directly affects the lives of virtually every Canadian. Unfortunately, at least from Ontario's point of view, this spirit of goodwill began to evaporate in late 1981 with the new federal budget proposals.

The 1981 Federal Budget

Ontario criticized the tax provisions in the November federal budget on three basic grounds.[21]

- It introduced sweeping proposals in corporate and personal income taxes without prior consultation.
- It directly attacked corporate and personal investment incentives which were particularly important to the Ontario economy.
- It treated the overall increase in provincial tax yields from the personal and corporate income taxes resulting from the controversial measures as automatic federal transfers to the provinces.

Ontario was concerned about several personal income tax proposals. Specifically, the restricted deductibility of interest expenses related to investment will discourage individuals from risk taking. The replacement of the previous income-averaging provisions with limited forward averaging, including prepayment of taxes at the top marginal rates, will impact severely on taxpayers with irregular or cyclical income receipts, such as farmers and small businessmen. This group is further affected by the restrictions on the reserve provisions available to ease the tax burden on capital gains resulting from the sale of a farm or business. The capacity for tax-free rollover of retirement and termination benefits has been significantly reduced. Finally, investment income accrued in annuities and life insurance policies will be taxable every three years rather than at maturity, thereby requiring taxpayers to pay tax on income that usually will not be received for a number of years.

Ontario's criticism was related not only to the specific proposals, but also to the potential damage to the climate of confidence in Canada resulting from such proposals and the way in which they were introduced. While the federal government did respond positively to some of the criticism levied against its proposals, the very fact that it introduced them in the first place severely shook business confidence. Moreover, this happened at a time when individual investors and businesses were already plagued by high interest rates and unsettled economic conditions.

In the area of corporate income taxation, Ontario has at least one course open if its views are not heeded in Ottawa. Since the Province administers its own corporate income tax, it need not parallel federal policies and thus does not have to burden corporations with inappropriate taxation policies. However, current arrangements with respect to the personal income tax compel Ontario to parallel federal measures even though they may not be in the best interests of the people of Ontario. Not only may Ontario be an unwilling partner in policies it feels are misguided, but it actually magnifies their impact simply by virtue of sharing the common tax base.

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[21]Hon. Frank S. Miller, *Statement to the Legislature on the Federal Budget,* November 13, 1981; Hon. Frank S. Miller, *Statement on Federal-Provincial Fiscal Arrangements* made to the Federal-Provincial Conference of Finance Ministers in Halifax, November 23-24, 1981; Hon. Frank S. Miller, *Statement to the Legislature on the Finance Ministers' Meeting in Halifax, November 23-24, 1981,* November 26, 1981; Hon. Frank S. Miller, *A Program for Restoring Confidence in the Canadian Economy,* a statement made to the Federal-Provincial Conference of Finance Ministers in Toronto, December 14, 1981; Hon. Frank S. Miller, *Statement to the Legislature on the Ministers of Finance Meeting, December 14-15,* December 16, 1981; Hon. Frank S. Miller, "Fiscal Federalism in Canada: The Record to Date, The Challenge Ahead", Budget Paper B, *Ontario Budget 1982* (Toronto: Ministry of Treasury and Economics, 1982).

Consequently, Ontario must seriously review ways in which it can more effectively keep personal income tax policy sensitive to the needs of the people of Ontario. The most dramatic and direct way of accomplishing this would be for the Province to opt out of the Tax Collection Agreement and establish its own personal income tax administration system. Clearly, this is not the option that Ontario would prefer. Far better would be a renewal of consultation and cooperation between the two levels of government so that the Ontario personal income tax system remains in federal administrative hands but is made more sensitive to the priorities of the Province. Nevertheless, the Province has decided to examine the option of creating its own system. The parameters for such a review are outlined in the next section.

Approaching a Repatriated Income Tax

Some Issues

Administration

The repatriation of the Ontario income tax system would entail significant start-up and operating costs, as well as greater paperwork burden for taxfilers.

A Provincial administrative body to oversee the collection of Ontario tax would be required. The functions of the body would include:

- collection of tax:
  - withholdings at source;
  - periodic payments by self-employed persons;
  - annual payments with tax returns;
- issuing refund cheques;
- assessing and auditing tax returns;
- providing interpretations and tax rulings;
- printing of tax returns;
- computerization of tax returns;
- collation and matching of information slips;
- public information;
- administering tax credit programs; and,
- preparing taxation data and statistics.

These functions entail added costs of administration. However, the Province has extensive experience in collecting taxes, having administered for many years sophisticated tax collection operations for corporation income tax and retail sales tax. This expertise could be drawn upon in the establishment of a personal income tax collection mechanism.

Efforts could be made to minimize these costs. The number of returns, along with the time required to process each return, directly affect the costs of operating an income tax system. Any reduction in the number of returns and any improvement in simplicity would bear directly on costs. The move at the federal level to a "short form" for those in straightforward income situations is an example of how simplicity can save time and money. Similarly, the switch in 1980 to a tax grant from a tax credit for property and sales taxes paid by Ontario senior citizens nearly halved the number of taxfilers in that age group.[22] Further reductions in filing requirements could be sought.

[22]For a discussion of the Ontario Tax Grants for seniors, see Hon. Frank S. Miller, "Direct Property Tax Relief for Ontario Pensioners", Budget Paper B, *Ontario Budget 1980* (Toronto: Ministry of Treasury and Economics, 1980).

It is unlikely that the definition of employment income for Provincial income tax purposes would deviate from the federal definition. Consequently, employers would have little difficulty in accommodating a Provincial "T4" slip. Furthermore, employees would not face the confusing situation of which definition fits which tax return, or why they differ in the first place.

To be effective, however, any system must have public understanding and acceptance. This would involve an extensive process of consultation and public discussion about the advantages and disadvantages of such a system.

Tax Harmony

One of the benefits of the current Tax Collection Agreements is the harmonization of tax policy which occurs automatically in nine provinces. Repatriation of the Ontario personal income tax could have significant implications for this benefit.

The personal income tax is an important fiscal policy tool, particularly with regard to stabilization of the economy. A separate Ontario income tax system would reduce the potential efficacy of federal policy moves in this area. However, if Ontario did decide to administer its own income tax, an objective would obviously be to maintain tax policies as consistent as possible with those of the federal government. With consultation and cooperation between the two levels of government, it should be possible to maintain fiscal policy harmony.

Ontario Priorities

Ontario has specific concerns about the treatment of investors and investment income. A separate income tax system would give Ontario flexibility to determine the suitable tax treatment of interest expenses, capital gains reserves, and the treatment of capital gains income. For example, it would be possible to examine the option of indexing the cost base for capital gains, or to treat truly speculative gains differently from more productive investment gains. It would also be feasible to consider the entirely separate tax treatment of investment income under a distinct rate schedule. Other specific measures, such as a stock savings plan, could be reviewed to determine whether they would productively create investment and jobs in Ontario.

An Ontario personal income tax system would also allow the Province to determine the appropriate mix of burden and incentive across all income levels. It would create the possibility of finding the right balance between economic and revenue needs and of tailoring the tax system more closely to the characteristics of the people of Ontario.

When a government enters the tax collection field, it is usually suggested that it wants to raise more revenue. In the case of the personal income tax, this argument has no validity, since the Province can raise more revenue simply by raising its rate under the existing Tax Collection Agreement. Most other provinces already have higher tax rates than Ontario. There are, however, other more important considerations such as the scope to raise revenue from taxpayers in a fair and appropriate manner. Under the current arrangements, Ontario must change tax rates across-the-board. In some cases, this may be appropriate. The choice to do otherwise, which does not presently exist, could result from a repatriated personal income tax system.

Conclusion

This section has raised some of the issues that would be involved if the Province was to consider collecting its own income tax. A great deal of further discussion and research is necessary before any recommendations can be formulated or any decisions made. To this end, the Ontario Economic Council under the Chairmanship of Dr. Thomas Courchene has been asked to examine the economic implications of an Ontario-run personal income tax.

APPENDIX A: THE HISTORY OF THE PERSONAL INCOME TAX[23]

The Early Years

Both the federal government and the provinces are able to levy direct taxes. One such tax is the personal income tax. Provinces have had longer involvement with the personal income tax, some since shortly after Confederation. The federal government first imposed personal income tax in 1917 to fund the war effort.

By 1930, only three provinces and the federal government levied personal income tax. However, the economic problems of the 1930s put severe fiscal pressure on provincial governments. As a result, by 1940, all provinces except Nova Scotia and New Brunswick were levying a personal income tax.

In the first years of joint occupancy of the personal income tax field, certain administrative difficulties arose. The problems were partially solved when a few of the provinces (including Ontario) agreed to let the federal government collect their personal income tax. However, numerous problems remained. Furthermore, the severe economic problems of the Depression showed no signs of abating. As a result, the Rowell-Sirois Commission was appointed in 1937 to examine, among other things, the appropriateness of more than one order of government levying personal income tax.[24]

The Commission reported in 1940. One of its recommendations was that provinces withdraw from the personal income tax field, leaving it solely to the federal government. In return, the federal government would compensate the provinces. The net result would be a more orderly and efficient personal income tax system.

The Tax Rental Agreements: 1941 to 1962

At a Dominion-Provincial Conference in 1941, the recommendation to allow the federal government sole occupancy of the personal income tax failed to secure approval. However, in order to consolidate Canada's war effort, the federal government required unrestricted access to the income tax fields. As a result, the provinces agreed to "rent" their income tax fields to the federal government in return for compensation in one of two forms. A province could receive its expected revenue yield in 1941 or the net cost of servicing the provincial debt for fiscal 1940-41 less succession duties collected. Ontario opted for the former.

Following the war, tax rental agreements were renegotiated for the period 1947-52. This allowed the federal government to direct post-war development and eliminated many of the difficulties that had arisen prior to the war.

Ontario and Quebec did not sign agreements in 1947. Instead, in 1950, Ontario indicated its intention to introduce a five per cent personal income tax. However, since

[23]Much of the information in this Appendix comes from federal documentation of tax sharing and tax collection arrangements. The primary source is a draft discussion paper originating within the Department of Finance.

[24]The Rowell-Sirois Commission was the familiar title of The Royal Commission on Dominion-Provincial Relations, established in 1937.

Ontario did not have the means to collect the tax, and since the federal government refused to collect it on Ontario's behalf, the tax was never proclaimed. Instead, Ontario agreed to receive five per cent of 1948 federal tax rates applied to 1948 incomes in the Province.

Further agreements were negotiated for the 1952-57 and 1957-62 periods. The nature of the tax rental agreements changed dramatically. Compensation was linked directly to expected tax yield according to a standard tax. For personal income tax, the standard tax was 10 per cent of federal personal income tax collected in the province.

The tax rental agreements created problems for both the federal government and the provinces. Officially, the federal government was viewed as the only taxing body, yet a significant amount of revenue went to the provinces. The provinces were experiencing rising expenditures and were in need of more revenue to meet new responsibilities. Provinces were hesitant to levy their own taxes since they were not prepared to establish their own collection mechanisms.

The Tax Collection Agreements: 1962 to Present

In 1961, the federal government decided to discontinue all tax rental agreements upon expiration on March 31, 1962. Instead, it proposed an abatement of federal tax. For 1962, the federal tax abatement was 16 points of federal personal income tax. The abatement rose over the next four years, eventually reaching 24 points in 1966.

The federal government agreed to collect provincial personal income tax free of charge. However, provinces were required to establish a single tax rate to be applied to a common tax base, called basic federal tax. No variations were allowed. Quebec again declined to participate.

The new Tax Collection Agreements had positive and negative implications for the provinces. On the positive side, provinces did not have to set up tax collection operations. Furthermore, additional revenue could be raised by increasing the provincial tax rate. On the negative side, the restrictions of the Agreements left the provinces with no say in personal income tax policy. Federal control of the tax base could have considerable impact on provincial revenues. Also, provincial tax rates were implicitly tied to the federal abatement. Any attempt to impose a higher rate would be perceived to be excessive taxation.

By 1971 the federal abatement had increased to 28 points, an additional four points having been transferred as partial funding for post-secondary education. Throughout this period, Ontario's tax was virtually identical to the federal abatement, and at no time exceeded it.

Major tax reform legislation became effective for the 1972 taxation year. As a result of these measures, the tax base shrunk slightly. It would take 30.5 points of the new lower base to derive the same Provincial revenue as under the pre-reform system. The abatement system was abandoned. Instead, federal marginal tax rates were set to yield a new basic federal tax to which the new Ontario rate of 30.5 per cent applied. The two systems are compared in Table A-1.

Despite provincial protestations to the contrary, the federal government maintained that tax reform would yield the provinces at least as much revenue as the pre-reform system. The federal government backed up this claim with a Revenue Guarantee whereby any shortfall in provincial revenue that might occur from 1972 to 1976 would be covered by the federal government. As it turned out, the federal

Comparison of Pre-Reform and Post-Reform Tax System (dollars) — Table A-1

Pre-Reform	
Basic federal tax	100.00
less federal abatement	28.00
Federal tax payable	72.00
Ontario tax (28 per cent of basic federal tax)	28.00
Total tax payable	100.00
Post-Reform	
Basic federal tax	76.63
Ontario tax (30.5 per cent of basic federal tax)	23.37
Total tax payable	100.00

government's estimates were too high and it had to make up the differences under the Revenue Guarantee.

In 1977, the tax-sharing arrangements between the federal government and the provinces again underwent a major revision with the introduction of the new Established Programs Financing arrangement. This arrangement involved transfers of cash and tax room to the provinces to represent the federal contribution to health and post-secondary education. Effectively, 9.143 personal income tax points were transferred to the provinces by means of lower federal marginal rates. Ontario's rate was subsequently set at 44 per cent of basic federal tax.[25] The rate was increased to 46 per cent in 1981 and to 48 per cent in 1982.

[25]For a detailed discussion of the new arrangements and the striking of the Ontario tax rate, see Hon. W. Darcy McKeough, "Federal-Provincial Fiscal Reforms", Budget Paper B, *Ontario Budget 1977* (Toronto: Ministry of Treasury, Economics and Intergovernmental Affairs, 1977).

APPENDIX B

Revenue Canada Taxation — Revenu Canada Impôt

T1 GENERAL-1981

13

1981 Federal and Ontario Individual Income Tax Return

Identification

Family or Last Name (Please print)
Mr.
Mrs.
Miss
Ms.

Usual First Name and Initials (Please print)

Present Address (Please print)

Number, Street and Apt. No., or P.O. Box No. or R.R. No.

City

Province or Territory — *Postal Code*

Is this your first Income Tax return? Yes 1☐ No 2☐

If 'No', please state year for which last return filed. 19

Name on last return: same as above ☐ or

Address on last return: same as above ☐ or

Social Insurance Number — *As on your Social Insurance Number card*

Date of Birth — *Day* *Month* *Year*

Province or Territory of Residence on December 31, 1981, was:

If self-employed in 1981, please state province where business located:

On December 31, 1981, I was: Married 1☐ Widow(er) 2☐ Divorced 3☐ Separated 4☐ Single 5☐

Usual First Name of Spouse

Address of Spouse: same as mine ☐ or

Spouse's Social Insurance Number

If you became or ceased to be a resident of Canada in 1981, please give:

Date of Entry 1 *Day* *Month* or Departure 2 *Day* *Month*

Type of work or occupation in 1981

Name of present employer

Calculation of Total Income

			$	¢
Income from Employment	Total Earnings Before Deductions from Box C on all T4 slips (attach copy 2 of T4 slips)	01		
	Commissions from Box L on all T4 slips, included in above total	02		
	Other employment income including adult training allowances, tips and gratuities, etc. (Guide item 3; please specify)	03		
	Total employment earnings (add lines 01 and 03)	04		
	Subtract: Employment expense deduction (Guide item 4) If line 04 above is $16,667 or more claim $500.00 If less, claim 3% of line 04	05		
	Other allowable expenses (Guide item 5; please specify)	06		
	Total employment expenses (add lines 05 and 06)	07		
	Net employment earnings (subtract line 07 from line 04)	08		
Pension Income	Old Age Security Pension (attach copy 2 of T4A(OAS) slip)	09		
	Canada or Quebec Pension Plan benefits (attach copy 2 of T4A(P) slip)	10		
	Other pensions or superannuation (attach copy 3 of T4A slips)	11		
Income from Other Sources	Taxable Family Allowance payments (Guide item 7; attach copy of TFA1 slip)	12		
	Unemployment Insurance benefits (attach copy 2 of T4U slip)	13		
	Taxable amount of dividends from taxable Canadian corporations (attach completed Schedule 4)	14		
	Interest and other investment income (attach completed Schedule 4)	15		
	Rental income (Schedule 7) Gross 83 — Net	16		
	Taxable capital gains (Allowable capital losses)—complete and attach Schedule 2	17		
	Other income (Guide item 17; please specify)	18		
Income from Self-Employment	Report both 'Gross' and 'Net'. (Guide item 18). Provide other information concerning self-employment on page 3.			
	Business income Gross 84 — Net	19		
	Professional income Gross 85 — Net	20		
	Commission income Gross 86 — Net	21		
	Farming income Gross 87 — Net	22		
	Fishing income Gross 88 — Net	23		
Total Income	(add lines 08 to 23 inclusive — please enter this amount on line 24 on page 2)	24		

13 Please do not use this area 32

Please do not use this area 900

2 Calculation of Taxable Income

	Line	$ ¢
Total Income (from line 24 on page 1)	24	

Deductions from Total Income

	Line	$ ¢
Canada or Quebec Pension Plan contributions (Guide item 19)		
Contributions through employment from Box D on all T4 slips (maximum $239.40)	25	
Contribution payable on self-employed earnings (from page 3)	26	
Unemployment Insurance premiums from Box E on all T4 slips (maximum $294.84; Guide item 20)	29	
Registered pension plan contributions (Guide item 21)	32	
Registered retirement savings plan premiums (Guide item 22; attach receipts)	33	
Registered home ownership savings plan contributions (Guide item 23; attach receipts)	34	
Annual union, professional or like dues (Guide item 24; attach receipts)	35	
Tuition fees—claimable by student only (Guide item 25; attach receipts)	36	
Child care expenses (complete and attach Schedule 5)	37	
Allowable business investment losses (Guide item 27)	38	
Other deductions (Guide item 28; please specify)	39	
Add lines 25 to 39 inclusive	40	

Net Income (subtract line 40 from line 24) 41

Claim for Personal Exemptions

Basic Personal Exemption — **Claim $3,170.00**

Age Exemption—If you were born in 1916 or earlier — Claim $1,980.00

If you did not receive the Old Age Security Pension, attach a letter giving reasons.

Married Exemption (Guide items 31 and 32)—If applicable, please check √ box 1. or 2.

Married on or before December 31, 1981, and supported spouse in 1981

1. whose net income in that year, while married, was not over $490. 1. ☐ Claim $2,780.00

2. whose net income in that year, while married, was over $490. but not over $3,270. 2. ☐ 3,270 00 — 42

Subtract: spouse's net income while married

If you became married in 1981, please give date of marriage — Claim

Exemption for Wholly Dependent Children *See Guide item 34.*

Provide details below and claim according to child's age and net income. Do not claim here for a child you have claimed on Schedule 6. See Guide item 34 if child's net income exceeds limit.

Children born in 1964 or later—Claim $590 for each child whose net income was not over $2,090.

Children born in 1963 or earlier—Claim $1,090 for each child whose net income was not over $2,180 and who, if born in 1959 or earlier, was in full-time attendance at a school or university or was infirm.

Name of child (attach list if space insufficient)	*Relationship to you*	*Date of birth of child Day*	*Month*	*Year*	*If born in 1959 or earlier state whether infirm or school attended*	*Net income in 1981 $*	*Claim*

Total claim for wholly dependent children 43

Additional Personal Exemptions from Schedule 6 attached 44

Total Personal Exemptions (add above items) 45

Subtract line 45 from line 41 46

Other deductions from Net Income

Standard deduction Claim $100 (no receipts required) **or** total at line 50 below, **but not both** 47

	Line	
Medical expenses—(attach receipts and completed Schedule 9)	48	
Subtract: 3% of 'Net Income' (line 41 above)		
Allowable portion of medical expenses		
Add: **Charitable donations** (attach receipts)	49	
Total *(If this amount is greater than $100, enter on line 47 above)*	50	

	Line	
Interest, dividends and capital gains deduction (Guide item 40; attach completed Schedule 4)	51	
Pension income deduction (Guide item 41)	52	
Deduction for blind persons or persons confined to a bed or wheelchair (Guide item 42) Claim relates to: Self ☐ or dependant other than spouse (specify)	53	
Education deduction (Guide item 43; attach completed form T2202 or T2202A)	54	
Eligible deductions transferred from spouse (Guide item 44; attach completed Schedule 3)	55	
Gifts to Canada or a province (Guide item 45; attach receipts)	56	
Unemployment Insurance benefit repayment payable from page 3 (Guide item 46)	58	
Non-capital losses of other years (Guide item 48)	59	
Capital losses of other years (1972 to 1980) (Guide item 49)	60	
Add lines 47, 51 to 60 inclusive	61	

Taxable Income (subtract line 61 from line 46—enter this amount on page 4) 62

Canada Pension Plan Contribution on Self-Employed Earnings (Guide item 19)

	$ ¢	$ ¢
Contributory Self-Employed Earnings		
Add: Contributory earnings from employment from Box C or Box I of T4 slips		
Equals: Total Contributory Earnings		
Subtract: Basic Canada Pension Plan Exemption of $1,400		
Equals: Earnings Subject to Contribution (maximum $13,300)		
Required Contribution (3.6% of 'Earnings Subject to Contribution': maximum $478.80)		
Subtract: Contributions through employment *(from T4 slips)*		
	X 2 =	
Canada Pension Plan Contribution Payable on Self-Employed Earnings (Please enter this amount on line 26 on page 2 and also on line 68 on page 4.)		

Unemployment Insurance Benefit Repayment Payable (Guide item 46)

	$ ¢	
Unemployment Insurance benefits from line 13 on page 1		
Subtract: Benefits repaid in the year, if any (must be supported by official receipt "Statement of Benefits Repaid"), and claimed at line 39 on page 2		
Net Unemployment Insurance benefits received in the year		(A)
Net Income from line 41 on page 2		
Subtract: Base Amount	24,570 00	
Net Income in excess of Base Amount *(if negative, enter zero)*		(B)
Unemployment Insurance Benefit Repayment Payable—30% of Amount (A) or (B), whichever is less. (Please enter this amount on line 58 on page 2 and also on line 69 on page 4.)		

Calculation of Federal Political Contribution Tax Credit (Guide item 54)

	$ ¢	$ ¢
Total Federal Political Contributions (attach receipts) (Please enter this amount also on line 960 on page 4.)		
Allowable credit—75% of first $100 of 'Total Federal Political Contributions', credit is		
50% of next $450 of 'Total Federal Political Contributions', credit is		
33⅓% of amount of 'Total Federal Political Contributions' exceeding $550, credit is		
Total Allowable Federal Political Contribution Tax Credit (maximum $500)—(Please enter this amount on line 64 on page 4.)		

Self-Employment—You must file a Statement of Income and Expenses and a Balance Sheet with your return. (Guide item 18)

Enter amount of salary or wages paid in the year to spouse (if partnership, enter only your share) $ ¢

If you have employees, provide your Employer's Remittance Account Number

Business name of self-employment

Business address of self-employment

Type of business, profession or activity

Indicate the principal product(s) mined, manufactured, sold (wholesale, retail) or services provided, giving the approximate percentage that the revenue from each is of the total revenue 1. ______ % 2. ______ % 3. ______ %

Product or service | Product or service | Product or service

Names of partners, if any

If farming, location of farm headquarters	Total acreage	Cultivated acreage

4 Summary of Tax and Credits There are two methods of tax calculation (see Guide item 51).

Taxable Income from line 62 on page 2 $

		$	¢
Federal Tax Payable from Tax Table in Guide or from line 63 on Schedule 1	63		
Subtract: **Federal Political Contribution Tax Credit** from calculation on page 3	64		
Federal Tax Payable Before Business Investment Tax Credit			
Subtract: **Business Investment Tax Credit** from form T2038(IND.) (Guide item 55)	65		•
Federal Tax Payable Before Employment Tax Credit			
Subtract: **Employment Tax Credit Claimed** from form T2208 (Guide item 56)	66		
Net Federal Tax Payable			
Add: **Ontario Tax Payable** from Tax Table in Guide or from line 67 on Schedule 1	67		
Canada Pension Plan Contribution Payable on Self-Employed Earnings from page 3	68		
Unemployment Insurance Benefit Repayment Payable from page 3 (Guide item 46)	69		
Total Payable	70		•

Net Current Year Employment Credits
959 $

Total Federal Political Contributions
960 $

Tax Adjustments
961 $ •

Foreign Taxes Paid
962 $ •

Net Foreign Income
963 $

Total Investment in Qualified Property
958 $

964 $

965 $

966 $

If taxpayer is deceased, please give date of death

967 Day Month Year

975

		$	¢
Total tax deducted per information slips	71		•
Ontario Tax Credits (Guide item 68)	74		•
Canada Pension Plan Overpayment (Guide item 19)	75		•
Unemployment Insurance Overpayment (Guide item 20)	76		•
Amounts paid by instalments	77		•
Child Tax Credit (from Schedule 10)	78		•
Total Credits			

Please enter this difference in applicable space below.

A difference of less than $1.00 is neither charged nor refunded.

Refund 79 •

Balance Due 80 •

Amount Enclosed •

Please attach cheque or money order **payable to the Receiver General. Do not mail cash.**
Payment is due not later than April 30, 1982.

Name and address of any individual or firm, other than the taxpayer, who has prepared this return for compensation.
Name
Address

Telephone

I hereby certify that the information given in this return and in any documents attached is true, correct and complete in every respect and fully discloses my income from all sources.

Please sign here

Date Telephone

Form authorized and prescribed by order of the Minister of National Revenue for purposes of Part I of the Income Tax Act, Part I of the Canada Pension Plan and Part VIII of the Unemployment Insurance Act, 1971.

It is a serious offence to make a false return.

Canadian Human Rights Act Federal Information Bank number 15605